BEFORE THE
SURFACE TRANSPORTATION BOARD

WESTERN FUELS ASSOCIATION, INC. and BASIN ELECTRIC POWER COOPERATIVE, INC.	)	**PUBLIC VERSION**
Complainants,	)	
v.	)	**Docket No. 42088**
BNSF RAILWAY COMPANY,	)	
Defendant.	)	

VERIFIED STATEMENT ON SURREBUTTAL OF MESSRS. KLICK AND FISHER

We are John Klick and Benton Fisher of FTI Consulting, Inc. We have appeared previously in this case as witnesses for defendant BNSF Railway Company ("BNSF") and our qualifications are set out in Section IV of BNSF's Reply Evidence. We were asked to respond to the September 30, 2005 Rebuttal Evidence and Argument of complainants Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. ("WFA/Basin") in three areas where the complainants' evidence either exceeded the scope of proper rebuttal evidence in a SAC proceeding or where the complainants' evidence is demonstrably inaccurate. Our discussion of those issues is set out below.

I. WFA/Basin's New Evidence on BNSF's Fuel Hedging Practices

On opening, WFA/Basin argued that the Board should use BNSF's system-average fuel price in the SAC analysis even though those prices were below the location-specific fuel prices BNSF actually pays for fuel in the Powder River Basin ("PRB"). WFA/Basin's rationale for using the system-average fuel price was that the stand-alone railroad -- the LRR -- would have a very large fuel requirement in the PRB and, as a result, fuel suppliers would offer the LRR fuel

at a price equal to or below prices currently available to BNSF.[1] On reply, BNSF showed that WFA/Basin's speculations about the impact of the LRR's entry into the market were entitled to no weight. BNSF also identified the actual prices it paid for fuel at the locations where the LRR would obtain fuel and BNSF used those location-specific prices in the SAC fuel cost calculations.

On rebuttal, WFA/Basin present a new argument in support of their use of BNSF's system-average fuel price in the SAC calculations, namely, that the system-average fuel price, unlike the location-specific fuel prices used by BNSF, reflects the effects of BNSF's fuel hedging program, "which reduced BNSF's overall 2004 fuel costs by 20 percent and its 4Q04 fuel costs by 24 percent."[2] WFA/Basin claim that the LRR would hedge its fuel purchases as well and assert that "there is no reason to believe it could not achieve the same result as BNSF." *Id.* To implement this assumption that the SARR would benefit from the same fuel hedges carried out by BNSF, WFA/Basin argue it is appropriate to use BNSF's post-hedge, system-average 4Q04 fuel costs which assumes a 24 percent reduction in the costs that LRR would actually incur in purchasing fuel from its fuel suppliers at Guernsey, Wyoming.[3] Since the Board's DCF model takes the SARR's 2004 costs and projects them using the RCAF-U index, WFA/Basin's approach effectively assumes that the LRR's actual fuel costs will be reduced by 24 percent *in each year of the DCF period* as a result of its hypothetical fuel hedge program in 2004.

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[1] WFA/Basin Opening Nar. at III-D-7 to 12.

[2] WFA/Basin Rebuttal Nar. at III-D-16.

[3] WFA/Basin rebuttal electronic workpaper "LRR Operating Expenses Reb.xls" shows that WFA/Basin use 4Q04 fuel prices which reflect a hedge benefit of 24 percent.

It is not appropriate for the complainant in a SAC case to present such a change to its SAC assumptions on rebuttal, and as BNSF explains in the accompanying Motion to Strike, the Board should strike WFA/Basin's fuel hedging evidence from the record. WFA/Basin are not entitled to present new arguments supporting their assumptions on SARR fuel costs when those arguments could and should have been presented on opening. In the alternative, if the Board does not strike WFA/Basin's new evidence and argument relating to BNSF's fuel hedging program, the Board should reject WFA/Basin's arguments about fuel hedging on the merits. The effects of a defendant's real world fuel hedging activity in a given quarter have no place in a long run SAC analysis. It would be especially inappropriate to assume, as WFA/Basin do, that the extraordinary benefits BNSF achieved in one quarter -- 4th quarter 2004 -- would be repeated in every year of the DCF period.

First, the purpose – and typical effect – of hedging fuel prices is to manage risk and create greater certainty with respect to future fuel costs.[4] Hedging is a form of insurance that protects a railroad against future unexpected fluctuations in price, particularly short-term price spikes. As BNSF explained in its 2004 annual report, it "maintains a program to hedge against

[4] *See, e.g.*, BNSF surrebuttal electronic workpaper "Mass Transit.pdf," Jeffrey LeMunyon, "Managing Your Money: Controlling Volatile Fuel Costs," *Mass Transit*, Sept.-Oct. 2005 ("hedging is the process of either reducing or eliminating the range of probable energy costs over a future time period. This is done by 'locking in' the price today for future needs"). *See also* BNSF Surrebuttal electronic workpapers "A Beginners Guide to Hedging.pdf" ("The best way to understand hedging is to think of it as insurance. When people decide to hedge, they are insuring themselves against a negative event. This doesn't prevent a negative event from happening, but if it does happen and you're properly hedged, the impact of the event is reduced"); "The Basics of Hedging.pdf" ("Hedging is the purposeful act of attempting to reduce price risk. . . . Hedging is not taking a speculative position in the futures market and hoping that it makes money"); "An Introduction to Hedging Agricultural Commodities with Options.pdf" ("The primary objective of hedging is not to make money. The primary objective of hedging is to minimize risks and this includes using hedging to minimize losses"); "Options Futures and Other Derivatives.pdf," John C. Hull, *Options, Futures & Other Derivatives*, at 70 (5th ed. 2003)("Many of the participants in futures markets are hedgers. Their aim is to use futures markets to reduce a particular risk that they face").

fluctuations in the price of its diesel fuel purchases."[5] While real-world railroads therefore hedge to avoid unexpected, and often short-term, price spikes, SAC cost projections assume certainty regarding future cost trends for purposes of evaluating the reasonableness challenged rates. The goal of mitigating risk that causes real-world railroads to hedge is not relevant to the SAC analysis, where future traffic and cost experience is assumed to have been projected with certainty. Application of SAC theory effectively insulates the SARR from real-world volatility and speculation – and precludes the very deviation between "expected" and "actual" prices that creates the potential to benefit from hedging. It would create an impermissible windfall to allow the SARR to obtain a benefit from hedging, as WFA/Basin assume.[6]

Second, and perhaps most important, hedging cannot be expected over the long term to generate net benefits. Indeed, there is no guarantee that hedging will actually reduce fuel prices on average over a given period. Rather, hedging often manages risk by giving up some of the benefit of potentially lower fuel prices in order to ensure that higher fuel prices will not be paid.[7] Over time, hedging arrangements will reduce the impact of both price increases and price

[5] WFA/Basin Section III-A Rebuttal electronic workpapers "2004 Annual Report - Fuel.pdf" at 52 (emphasis added).

[6] In *Wisconsin Power and Light Company v. Union Pacific Railroad Company*, Docket No. 42051, slip op. at 33 (served September 13, 2001), the Board recognized that risks associated with future uncertainty should not affect a SARR's costs: "To compensate UP in advance for the possibility that the projections may not be realized is neither necessary nor appropriate…." The same logic indicates that hedging, which is designed to deal with the future uncertainty over whether actual prices will deviate from projected prices, should not be taken into account in the SAC analyses either.

[7] *See* BNSF Surrebuttal electronic workpapers "Mass Transit.pdf" ("Will hedging always result in lower net fuel costs within a certain time frame? No. However, along with more certain future costs, the goal of any hedging strategy is to minimize cost over time while managing risk"); "A Beginner's Guide to Hedging.pdf" ("[H]edging, for the most part, is a technique not by which you will make money but by which you can reduce potential loss. If the investment you are hedging against makes money, you will have typically reduced the profit that you could have made, and if the investment loses money, your hedge, if successful, will reduce that loss").

declines, but those effects typically offset each other over the long run, thereby, reducing volatility but not generating net revenues. BNSF's own fuel hedging history since 1998 shows that BNSF incurred a net benefit in some years (by reducing its actual fuel costs through hedging) and a net loss in other years (by increasing its actual fuel costs through hedging). *See* BNSF Surrebuttal Exhibit 1 at page 1.[8] Indeed, the amount of the gain or loss associated with BNSF's fuel hedging program varied dramatically from year to year. *Id.* The BNSF hedge benefit ranged from a loss of about 12 percent in 1998 to a gain of approximately 20 percent in 2004. *Id.* The prospect of any net benefit from hedging in a particular year is far too speculative to be included in the SAC calculations.

Third, by using in its SAC calculations BNSF's 4th quarter 2004 system-average fuel price, which reflected an extraordinary 24-percent reduction from the specific fuel prices charged in the locations where the LRR would obtain fuel, WFA/Basin unreasonably assume that the SARR will consistently achieve hedge benefits that are extremely rare. Since 1998, BNSF has been able to achieve a 20 percent reduction in its fuel costs as a result of its hedging program in only one year -- 2004. *Id.* In other years, the hedge benefit was either much lower or resulted in an increase in fuel costs. *Id.* In fact, as noted previously, in 1998, BNSF's fuel costs *increased* by about 12 percent as a result of its fuel hedging program. *Id.* Other Class I railroads have had similar experience. *See* BNSF Surrebuttal Exhibit 1 at page 2. For example, under its fuel hedging program, Union Pacific's fuel costs were increased in some years (by one to 12 percent) and were reduced in other years by one to six percent. *Id.*

Finally, the large hedge benefits achieved by BNSF in 2004 resulted from the unusually volatile nature of fuel prices in 2004. The same level of benefits cannot be expected to recur on

[8] The BNSF Surrebuttal Exhibits referenced in this verified statement are included at tab 1.

an annual basis over the course of the next 20 years. Substantial cost reductions under a fuel hedging program tend to occur in years, like 2004, when fuel prices increase dramatically and unexpectedly. Fuel prices increased by 20 percent in 2004.[9] Consequently, if in 2003 a company had hedged some of its 2004 fuel prices through hedge arrangements that assumed that 2003 prices would remain through 2004, that company would likely have achieved substantial fuel savings in 2004. However, if fuel prices do not increase dramatically and unexpectedly in a given year, then a company cannot expect to achieve substantial savings under its fuel hedging program in that year. BNSF's own experience with hedging illustrates this point. As BNSF Surrebuttal Exhibit 1 shows, BNSF's hedge benefit has exceeded 6 percent in only two of the last seven years (2000 and 2004). Not surprisingly, fuel prices in each of those years increased dramatically -- by at least 20 percent. *See* WFA/Basin's Rebuttal Exhibit III-A-4.

WFA/Basin's SAC evidence contains their assumptions regarding how fuel prices will change on an annual basis from 2006 through the end of the DCF period, and those assumptions do not project large increases in fuel prices over any of the next several years.[10] To the contrary, they assume fuel prices will *decrease* by 0.8 percent annually in each of 2006 and 2007, and then increase by only 0.5 percent annually in each of 2008 and 2009.[11] Given the small changes in fuel prices that WFA/Basin forecasts in future years, it is implausible for them to assume that the SARR will achieve significant reductions in fuel price through hedging.[12]

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[9] WFA/Basin Rebuttal Exhibit III-A-4.

[10] WFA/Basin Rebuttal electronic workpaper "LRR Traffic and Revenues_WFABasinRebuttal.xls, worksheet "Non_RCAF_Rateadj."

[11] *Id.*

[12] WFA/Basin also have raised the issue of how to treat a defendant's fuel hedging activity in the calculation of variable costs. As explained in its Rebuttal Evidence, BNSF believes that the effects of the fuel hedging program should not be considered in determining the

II. WFA/Basin's Belated Challenge to the Reasonableness of BNSF's Fuel Surcharge

The common carrier pricing authority established by BNSF for the Laramie River movement, like a number of other BNSF common carrier pricing authorities for coal transportation and coal transportation contracts, contains a fuel surcharge. Specifically, the Laramie River pricing authority provides that "[a]ll freight rates cited herein are subject to the coal fuel cost recovery surcharge as set forth in BNSF Rules Book 6100-series, Item 3380."[13] This fuel surcharge is applicable when the U.S. average price of retail On-Highway Diesel Fuel ("HDF") for the month equals or exceeds $1.24 per gallon.[14] The resulting fuel surcharge is calculated as a percentage of the freight charges for each coal shipment. *Id.*

On opening, WFA/Basin claimed that the Board should disregard BNSF's fuel surcharge in calculating revenues associated with the issue traffic based solely on the argument that "[s]ince WFA/Basin's rates without rate adjustment are unreasonable, BNSF's rate adjustment mechanism (including fuel surcharges) -- which pushes up WFA/Basin's unreasonable base rate payments by an additional $495 million over the 20 year DCF period -- is clearly unreasonable as well."[15] WFA/Basin's SAC calculations therefore excluded all fuel surcharge revenues that BNSF has collected and will collect under the Laramie River common carrier pricing authority in

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variable costs for the SARR. *See* BNSF Rebuttal Nar. at II-22. However, the issues raised by BNSF's hedging activity are different as they relate to the variable cost and SAC cost calculations since the calculation of variable costs addresses actual historical costs while the calculation of SAC costs addresses the value of a future stream of costs. Regardless of how the Board treats BNSF's hedging activity in the calculation of variable costs, it would be improper, for reasons set out above, to consider any effects of BNSF's hedging activity in the calculation of SAC costs.

[13] WFA/Basin Opening Exh. I-2 at 1.

[14] This coal fuel surcharge effective October 2004 is included in BNSF's surrebuttal electronic workpapers at "current surcharge.pdf."

[15] WFA/Basin Opening Nar. at III-A-14 (emphasis in original).

calculating the revenues available to the SARR from the issue traffic. Instead, WFA/Basin calculated issue traffic revenues using only what WFA/Basin termed the base rate, which it escalated by the RCAF-U index.[16] However, WFA/Basin included in its SAC calculations the fuel surcharge revenues for other SARR shippers to whom BNSF charged the same fuel surcharge in the real world.

On rebuttal, WFA/Basin continue to exclude all fuel surcharge revenues from its SAC calculations for the issue traffic, but they also present a new argument for excluding those revenues. This argument, unlike the argument they made on opening, was directed at the reasonableness of the mechanics of BNSF's calculation of the fuel surcharge. WFA/Basin now claim that the fuel surcharge is unreasonable because it produces revenues in excess of the fuel costs that are supposed to be covered by fuel surcharge revenues.[17] Specifically, WFA/Basin now assert that (1) BNSF does not need a fuel surcharge because use of the RCAF-U index to escalate existing rates is adequate to protect railroads against fuel price increases; and (2) BNSF's fuel surcharge mechanism "vastly overstates BNSF's actual projected fuel cost increases." *Id.* Neither of these claims has merit.

A. Use of the RCAF-U Does Not Adequately Protect Against Fuel Price Increases

WFA/Basin claim that the RCAF-U index allows an adequate recovery of any increased railroad fuel costs incurred by BNSF. This claim is based on a comparison of the 2004 increase in the fuel component of the RCAF-U index to the actual 2004 increase in BNSF's fuel prices for Laramie River trains.[18] WFA/Basin assert that because the 2004 increase in the RCAF-U fuel

[16] *Id.*

[17] WFA/Basin Rebuttal Nar. at III-A-22 to 23.

[18] WFA/Basin Rebuttal Nar. at III-A-22 to 23.

component was comparable to BNSF's actual fuel cost increases, use of the RCAF-U to escalate the Laramie River rate must be appropriate. There are two obvious flaws in this argument.

First, the percentage increases in the RCAF-U fuel component and the actual fuel costs were not comparable. As shown in WFA/Basin's Rebuttal Evidence at III-A-22 to 23, in 2004 BNSF's fuel costs for the Laramie River trains increased by [ ] percent whereas the fuel component of the RCAF-U index increased by [ ] percent, a difference in the rate of change of about [ ] percent. *Id.*

Second, and more important, even if the percentage increase in the fuel component of the RCAF-U index were identical to the percentage increase in BNSF's actual fuel costs for the Laramie River trains, use of the RCAF-U index would not protect BNSF from fuel price increases because of the weight given to the fuel component in the RCAF-U index. The RCAF-U index is a composite, market-basket index in which costs in several areas, *e.g.* fuel, wages, materials and supplies, are weight-averaged to produce a single index value. The weight given to any single cost component in the RCAF-U is therefore critical to the accuracy of the RCAF-U index as a reflection of total cost changes.

However, the fuel component of the RCAF-U index is a lower proportion of total expenses than appropriate for heavy-haul unit coal trains. Specifically, the RCAF-U index assumes that fuel is 12.1 percent of a railroad's costs.[19] However, converting either of the parties' variable cost evidence for the issue traffic to fully allocated costs indicates that fuel actually constitutes 16-19 percent of BNSF's total movement costs for unit coal trains.[20] Thus,

[19] BNSF Surrebuttal electronic workpaper "RCAF.pdf."

[20] BNSF Surrebuttal electronic workpaper "fuel weighting.xls."

the weighting given to fuel in the RCAF index is too low for unit coal trains, so changes in fuel costs will not be accurately represented for that type of train in the RCAF index values.

The following simple hypothetical example illustrates how the RCAF-U index fails to recover a railroad's increased fuel costs in such circumstances. Assume that fuel prices increased by 35 percent in 2004, other railroad costs did not increase in that year, and the railroad's total costs were $10,000,000. Since the RCAF-U index assumes that fuel is only 12 percent of the railroad's costs, or $1,200,000, it provides a $420,000 recovery for the increase in fuel cost ($1,200,000 x 35 percent increase). However, if fuel actually accounts for 19 percent of the railroad's unit coal train costs, the railroad should recover $665,000 associated with the increased fuel cost ($1,900,000 fuel cost x 35 percent increase). In this hypothetical example, the RCAF-U index does not allow the railroad to recover over one-third of its increased fuel costs, even though it assumes the correct percentage increase in such costs.

B. BNSF's Fuel Surcharge Mechanism Does Not Overstate Incremental Fuel Costs

WFA/Basin's purported showing in Rebuttal Exhibit III-A-3 that BNSF's fuel surcharge mechanism vastly overstates BNSF's actual fuel cost increases is similarly flawed. WFA/Basin claim that BNSF's fuel surcharge over-recovers fuel cost increases by [ ] percent. But as shown in BNSF Surrebuttal exhibit 2, WFA/Basin's calculations are erroneous. For example, WFA/Basin's exhibit assumes the wrong 4Q04 common carrier rate to Laramie River station. Specifically, it assumes the rate from the north PRB mines, without fuel surcharge, is $6.71 per ton when in fact the rate, without fuel surcharge, is $6.15 per ton.[21] Consequently, the exhibit also incorrectly assumes the rate with fuel surcharge is $7.33, when the actual rate with fuel

[21] WFA/Basin Opening Exh. I-2 shows the 4Q04 common carrier rate from north PRB mines is $6.15.

surcharge is $6.707.[22] The exhibit also improperly reduced the fuel cost by including the effects of BNSF's hedging.[23] When these errors are corrected, the supposed over-recovery percentage calculated by WFA/Basin drops by more than half, from [ ] percent to [ ] percent. *Id.*

As further support for their claim that BNSF's fuel surcharge over-recovers its fuel cost increases, WFA/Basin assert erroneously in Rebuttal Exhibit III-A-3 that BNSF's average fuel cost increase was significantly lower than the HDF fuel cost increase from 3Q03 to 3Q04. Since the fuel surcharge is based on the HDF fuel index, this supposed discrepancy is cited as evidence that BNSF's fuel surcharge produces excessive revenues. But once again the comparison is misleading and erroneous. The BNSF fuel price used by WFA/Basin in this comparison improperly includes the effect of fuel hedging, which masks the actual underlying changes in BNSF's diesel fuel prices. When the effect of fuel hedging is removed, which is appropriate as explained above, the increase in BNSF's fuel cost (36.2 percent) exceeds the increase in the HDF fuel index (25.3 percent) from 3Q03 to 3Q04. *See* BNSF Surrebuttal Exhibit 2.

WFA/Basin's belated challenge to the reasonableness of BNSF's fuel surcharge is particularly misleading in light of the fact that BNSF announced a significant change in the coal fuel surcharge mechanism, to become effective January 1, 2006, after BNSF's filing of reply evidence but well before WFA/Basin's rebuttal filing. WFA/Basin failed to inform the Board of that change even though BNSF's new fuel surcharge mechanism directly affects the validity of WFA/Basin's argument that the fuel surcharge over-recovers BNSF's fuel costs.

On August 8, 2005, more than eight weeks before WFA/Basin submitted its rebuttal evidence in this case, BNSF sent a letter to all its customers, including WFA/Basin, attaching the

[22] WFA/Basin Rebuttal electronic workpaper "T&O WFA Reply.123."

[23] As explained in Section I above, the effects of hedging should not be considered in analyzing BNSF's SAC fuel costs.

new fuel surcharge that BNSF will apply to BNSF's local coal movements, like the Laramie River movement, and to BNSF's portion of Rule 11 shipments beginning January 1, 2006.[24] The new coal fuel surcharge is applied based upon BNSF's rail mileage between origin and destination points rather than as a percentage of the customer's freight bill. *Id.* at 1. Although other railroads continue to use a percentage-based fuel surcharge, BNSF is adopting the mileage-based fuel surcharge because "BNSF believes that moving to a mileage-based fuel surcharge will better align the fuel surcharge assessed to our customers with the actual incremental cost of transporting their goods." *Id.* at 4. Under the mileage-based surcharge, customers with shorter-haul movements, like the Laramie River movement, may be assessed a lower fuel surcharge than under the previous surcharge, while customers with longer movements may be assessed a higher surcharge. Indeed, as shown in BNSF Surrebuttal Exhibit 2, BNSF's recovery of incremental fuel costs for the Laramie River move under the new mileage-based fuel surcharge drops from [ ] percent of the change in fuel costs to [ ] percent.

BNSF's use of the new fuel surcharge beginning January 1, 2006 significantly affects the level of issue traffic revenues that are the subject of this rate reasonableness challenge. Accordingly, BNSF is restating its SAC revenue calculations to incorporate the use of the new mileage-based fuel surcharge, effective January 1, 2006.[25] At Tab 2 to this Verified Statement,

[24] This BNSF letter is included in BNSF's surrebuttal electronic workpapers at "new surcharge.pdf." Based on the terms of individual coal transportation contracts, the new fuel surcharge may also affect BNSF's contract movements.

[25] BNSF's revised revenue calculations appear in BNSF surrebuttal electronic workpaper LRR Traffic and Revenues_BNSF Rebuttal Response.xls," worksheet "ProjTonRev." BNSF has revised the revenues for the common carrier movements with a fuel surcharge, including the issue traffic revenues, to incorporate the new mileage-based surcharge effective January 2006. The application of the new fuel surcharge to contract movements will depend upon the terms of the individual contracts. While we have not investigated the impact of the new surcharge on specific contracts, application of the new fuel surcharge would not have a significant impact on the SARR revenues from those contract and, therefore, would not significantly affect the SAC

BNSF is including revised tables from the narrative and exhibits from sections III.A and III.H of BNSF's Reply Evidence that reflect the revised revenue calculations resulting from BNSF's use of the new coal fuel surcharge effective January 2006. For the convenience of the Board, BNSF is reproducing and filing with this Surrebuttal Verified Statement a complete set of electronic workpapers that contain the revised revenue calculations as well as all other SAC calculations.

C. BNSF's Fuel Surcharge Projections Are Reasonable

While WFA/Basin refuse to include fuel surcharge revenues in calculating SAC revenues for the issue traffic, they do include fuel surcharge revenues in calculating revenues for other shippers in the SARR traffic group whose contracts or common carrier pricing authorities contain a fuel surcharge. There is a basic dispute between the parties regarding how the fuel surcharge revenues for the non-issue traffic should be escalated. To project fuel surcharge revenues, WFA/Basin use the EIA's most recent forecast of diesel fuel price changes (hereafter "EIA Forecast").[26] In contrast, BNSF uses a Global Insight forecast of the fuel component of the RCAF-U index (hereafter "RCAF Fuel Forecast") to project fuel surcharge revenues.[27]

On rebuttal, WFA/Basin present misleading evidence purporting to demonstrate that BNSF's projection of the level of fuel surcharge revenues for non-issue traffic in future years

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analysis. Many of the contract movements with a fuel surcharge are interline movements that would not be subject to the new fuel surcharge, and many of those movements expire within the next few years so any modifications to the revenues would only affect revenues for a few years. Accordingly, we have not adjusted the SARR revenues of the contract movements to reflect the terms of the new fuel surcharge.

[26] WFA/Basin Rebuttal Nar. at III-A-27.

[27] BNSF Reply Nar. at III.A-29. BNSF used the same index to forecast fuel surcharge revenues for the issue traffic.

using the RCAF Fuel Forecast is flawed.[28] As explained above, BNSF's fuel surcharge is based upon the U.S. average price of retail On-Highway Diesel Fuel ("HDF"). According to WFA/Basin, their Rebuttal Exhibit III-A-4 shows that the EIA Forecasts of diesel fuel prices have historically done a better job than the RCAF Fuel Forecasts in predicting actual changes in HDF prices.

But Exhibit III-A-4 presents no information regarding how well the EIA Forecast and RCAF Fuel Forecast have projected changes in HDF prices. With respect to the EIA Forecast, that Exhibit merely contains historical information showing how HDF prices have actually changed over the last ten years compared to what the most recent EIA Forecast says have been the historical changes in diesel fuel prices over the last ten years. WFA/Basin's Exhibit therefore shows nothing more than that EIA is able accurately to measure historical changes in HDF prices. The rebuttal exhibit does not address the issue of how well the forecasts of the EIA Diesel Fuel index or the forecasts of the RCAF Fuel index have projected changes in diesel fuel prices over time.

In fact, review of the two forecasts indicates that the EIA Forecast has not been superior to the RCAF Fuel Forecast in projecting changes in HDF prices. BNSF Surrebuttal Exhibit 3 that compares how the respective fuel forecasts have performed. Specifically, the exhibit compares two earlier vintages of the same forecasts used by the parties in this case – the Global Insight RCAF Fuel Forecast from June 2001 and EIA's Diesel Fuel forecast from its 2002 Annual Energy Outlook – to the historical HDF prices shown in WFA/Basin Rebuttal Exhibit III-A-4. Notwithstanding the fact that the EIA Forecast was published six months after the

[28] WFA/Basin Rebuttal Nar. at III-A-27 to 28. While this evidence was responsive to BNSF's reply evidence, BNSF addresses it here in the interest of presenting a complete record as to the reasonableness of BNSF's fuel surcharge mechanism, an issue that was raised for the first time in WFA/Basin's rebuttal.

RCAF Fuel Forecast, it did not do a better job of forecasting diesel fuel prices. As shown in BNSF Surrebuttal Exhibit 3, while both forecasts accurately predicted the decreases in fuel prices that occurred in 2001 and 2002, the EIA Forecast predicted decreases in two of the next years (2003 and 2005) and a minimal increase of 0.4% in the other year (2004). Consequently, the EIA Forecast significantly understated the actual increases in the HDF prices in years 2003, 2004 and 2005. By comparison, the RCAF Fuel Forecast predicted increases in each year 2003 through 2005, of 2-4% annually and, thus, did a better job of predicting increases in HDF prices in those years.

The fact that both forecasts fell short of predicting the double-digit increases that have been experienced in 2003 through 2005 further supports BNSF's argument for using the RCAF Fuel index that it presented on Reply to forecast fuel surcharge revenues.[29] As explained on Reply, BNSF also uses that index to project SAC fuel costs. Use of the same index to project SAC revenues and costs mitigates the potential for distortion and inconsistent results.

III. WFA/Basin's Erroneous Evidence On The 25-Mile Block MSP Methodology

WFA/Basin's Rebuttal Evidence contains demonstrably erroneous evidence relating to BNSF's allocation of revenues between the SARR and the residual incumbent using the Board's MSP methodology modified to include 25-mile origination/termination credits instead of the 100-mile credits used as a default in the Board's Waybill Sample. WFA/Basin argue on rebuttal that the Board should reject the use of 25-mile origination/termination blocks in the MSP methodology because such an approach supposedly produces revenues for the SARR that deprive the SARR of the ability to realize economies of density that are available to the incumbent.

[29] BNSF Reply Nar. at III-A-29.

WFA/Basin's argument is as follows. They first claim that "the ICC and the Board have consistently rejected SARR divisions methodologies that set SARR divisions at levels equal to or near the incumbent's variable costs for providing service over the SARR." WFA/Basin Rebuttal Nar. at III-A-42. According to WFA/Basin, if a SARR's cross-over revenues are set at or below the incumbent's variable costs, the SARR will be unable to generate any contribution from the cross-over traffic to offset the joint and common costs of the SARR lines. WFA/Basin then purport to show that the revenues allocated to the LRR by the 25-mile block MSP approach in this case do not cover BNSF's variable costs of serving LRR cross-over traffic on the on-SARR segment of the through movement. WFA/Basin claim that BNSF's URCS aggregate variable costs for the on-SARR movements of the LRR's cross-over traffic are [ ] while the revenues allocated to the LRR for this traffic under the 25-mile block approach are only [ ]. According to WFA/Basin, the resulting R/VC of [ ] demonstrates that the LRR does not receive revenue divisions sufficient to cover BNSF's variable costs.

BNSF does not concede the premise of WFA/Basin's argument, namely, that there is something suspect about a divisions methodology that sets SARR revenue divisions at or near the incumbent's variable costs. That question, however, is beyond the scope of this surrebuttal. The point for present purposes is that the revenue divisions established under BNSF's 25-mile block approach substantially exceed the variable cost level, contrary to WFA/Basin's assertion on rebuttal. There is a fundamental error in WFA/Basin's calculation of BNSF's URCS variable costs for the SARR portion of the through movement on the SARR's cross-over traffic. The costs used by WFA/Basin -- [ ] -- result from the URCS cost procedures for developing variable costs, which automatically include a substantial interchange cost whenever costs for a *portion* of a through movement are developed. Because they were developed using

URCS Phase 3 procedures, the variable costs for the cross-over portion of the movement includes a component covering a non-existent interchange between the SARR and the residual incumbent.

The real-world BNSF does not incur such interchange costs on the through movements that are converted to interchange movements for SAC purposes. On the real-world BNSF, each of the cross-over moves is a through movement with no interchange. The non-existent interchange costs produced by the URCS procedure, however, are substantial and comprise over 15 percent of the total costs used by WFA/Basin in their comparison. As WFA/Basin acknowledge, it is the real-world BNSF cost of providing service over the on-SARR and off-SARR segments that the Board has determined is pertinent when revenue divisions are at issue. Indeed, the Board has held that "the revenue allocation issue should reflect, to the extent practicable, the *defendant carrier's* relative costs of providing service over the two segments."[30] The R/VC calculation sponsored by WFA/Basin should not, therefore, have included costs other than those incurred by the real-world BNSF.[31]

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[30] *Duke Energy Corp. v. Norfolk Southern Ry.*, STB Docket No. 42069, at 20 (served Nov. 6, 2003)(emphasis added). If the SARR's costs, which include the cost of a hypothetical interchange, were at issue, then BNSF's URCS costs would not be relevant. WFA/Basin calculated the SARR's variable costs for the cross-over movements to be [ ], thus producing an R/VC ratio of [ ] when the 25-mile block MSP methodology is used. *See* WFA/Basin Rebuttal electronic workpaper "LRR RAM Rates_4Q 2004-2024 Rebuttal.xls," tab "2005".

[31] The URCS variable cost figure relied upon by WFA/Basin was used in BNSF's reply evidence to determine the revenues available to the SARR under BNSF's contestability pricing approach. Arguably, the inclusion of an interchange cost in that avoidable cost calculation overstated BNSF's avoidable costs and therefore overstated the allocation of revenues to the SARR. But it is not necessary to address that issue here or to modify BNSF's contestability pricing evidence to show the impact of excluding interchange costs. BNSF's Reply Evidence showed that even with the inclusion of interchange costs in the avoidable cost calculation, which increases the SARR's revenues, LRR stand-alone costs substantially exceed LRR stand-alone revenues. BNSF Errata to Reply Evidence, Attachment 5, Table III.H-1.

A proper calculation of BNSF's aggregate URCS variable costs for those segments of cross-over movements on the SARR, excluding the non-existent interchange costs, yields aggregate variable costs of [ ].[32] When the correct figure is used to calculate an R/VC ratio in the aggregate for the cross-over traffic, the result is [ ], which means that BNSF's 25-mile block approach produces revenue divisions for the LRR more than sufficient to cover the real-world BNSF's variable cost of service over the on-SARR segment. The URCS variable costs already include a substantial road property and depreciation component, and the 25-mile block approach allocates significant additional revenues over the incumbent's URCS costs. Therefore, the 25-mile block approach provides the SARR with significant contribution from cross-over traffic for coverage of the SARR's joint and common costs.

We verify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

[32] BNSF surrebuttal electronic workpaper "LRRCoal.xls."

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John C. Klick	Benton V. Fisher